No. 85-1240

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Supreme Court, U.S.
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In The

Supreme Court of the United States

October Term, 1985

DANIEL A. TORRES, M.D., P.C., et al.,
Petitioners,

v.

HARRY V. EASTLICK, Trustee of North American Coin & Currency, Ltd.,
Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

RESPONDENT'S BRIEF IN OPPOSITION

JEFFREY STUART LEONARD
1840 First Interstate Bank Plaza
100 West Washington Street
Phoenix, Arizona 85003
(602) 254-5071

Counsel for Respondent

Daughton Feinstein & Wilson
Joanne T. Stark
Of Counsel

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RESPONDENT'S BRIEF IN OPPOSITION

Respondent respectfully requests that this Court deny the petition for a writ of certiorari, seeking review of the Ninth Circuit's opinion in this case.

STATEMENT OF THE CASE

Petitioners state (Petition ("Pet.") 5) that they agree with the facts as set forth by the United States Court of Appeals for the Ninth Circuit in its opinion. With one exception, described below, respondent accepts the Ninth Circuit's summary of facts as one made

"in the light most favorable to the plaintiff class . . ." (Petitioners' Appendix ("Pet. App.") A-2).

Respondent[1] does not accept petitioners' further characterization of, and conclusions drawn from, the facts as stated by the court of appeals. Petitioners contend (Pet. 6) that those facts show an intention to obtain money by "holding out" the appearance of a going concern, by not performing upon a representation that metals would be purchased, and by acting in a manner wholly inconsistent with the debtor's normal course of dealing, and that the debtor "falsely held out the appearance of a viable operation." None of the three courts which have considered this case has so found, and petitioners' contentions in this respect are merely argument.

The one respect in which respondent disagrees, for purposes of the Court's consideration of this petition, with the court of appeals' recitation of facts, is in that court's statement (Pet. App. A-3) that the company placed all receipts from new transactions during the week of September 13 through September 17 into the "Special Trust Account." In fact, those funds were deposited to the company's main depository account, together with all other receipts of the company. (Respondent's Appendix ("App.")).[2] Subsequently, checks in amounts equal to the amounts received from petitioners were written on the main depository account, and deposited to the "Special Trust Account." (App.).

REASONS FOR DENYING THE WRIT

The decision below neither conflicts with decisions of other federal courts of appeals on the same matter, nor with decisions of the Supreme Court of Arizona. The court of appeals, applying accepted principles of law to the distinctive facts of this case, reached a reasonable, permissible, and, indeed, correct, result.

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[1]Respondent Harry V. Eastlick has, since his participation in the proceedings below, been discharged as trustee of North American Coin & Currency, Ltd., which now operates pursuant to an approved and confirmed plan of reorganization. North American has changed its name to Norcap Financial Corporation. Norcap has no parent companies, and no subsidiaries (other than wholly-owned subsidiaries) or affiliates.

[2]These facts are contained in the deposition of David B. Weekly, who was the company's controller. Pertinent portions of that deposition are reproduced in the Appendix to this brief.

1. THERE IS PRESENTED BY THE DECISION BELOW NO CONFLICT WITH DECISIONS OF OTHER FEDERAL COURTS OF APPEALS ON THE SAME MATTER.

Although petitioners contend that the decision below conflicts with decisions of other federal courts, a comparison of their statements of general principles (Pet. 8-10) with the opinion of the court of appeals does not reveal such conflicts. It is true that property of others, held by the debtor in trust at the time of the filing of the petition, is not a part of the debtor's estate. 11 U.S.C. § 541(a), (b); *United States v. Whiting Pools, Inc.*, 462 U.S. 198, 205 n. 10 (1983). It is also true that neither the debtor nor its trustee has an interest in property acquired by the debtor's fraud, as against the rightful owners of the property. *In re Flight Transportation Corporation Securities Litigation*, 730 F.2d 1128, 1136 (8th Cir. 1984), *cert. denied sub nom. Reavis & McGrath v. Antinore*, ____ U.S. ____ 105 S. Ct. 1169 (1985); *In re Paragon Securities Company*, 589 F.2d 1240, 1242 (3rd Cir. 1978); *Nicklaus v. Bank of Russellville*, 336 F.2d 144, 146 (8th Cir. 1964). Petitioners and the court of appeals are in agreement as to both of these principles; the court of appeals found that no such fraud existed and, in fact, that "[i]f anything, the evidence indicates that the people responsible for managing NAC acted in good faith." (Pet. App. A-7).

Petitioners further argue that "actual" fraud is not a prerequisite to a finding that property is not properly a part of the bankruptcy estate, and that property obtained by "other tort," or by other "circumstances which make it inequitable that [the property] should be retained" (Pet. 9), will suffice. The court of appeals did not reject this possibility. It merely concluded that it would not exercise what is in fact its general equitable power to impose a constructive trust *"in the circumstances here presented"* (Pet. App. A-9) (emphasis added), and it examined those circumstances in considerable detail.

Petitioners' conclusory assertion that "[w]here an estate's property has been received through circumstances which make it inequitable that it should be retained by the one who holds only the legal title, courts will impose a constructive trust . . ." (Pet. 9), does not establish that such circumstances existed under the facts

of this case. As the court stated in *Gordon v. Spalding*, 268 F.2d 327, 331 (5th Cir. 1959), cited by petitioners (Pet. 9), "every transaction is judged by its own character and ingredients and acquires its legal status from these alone. . . ."

The several decisions of courts of appeals, cited by petitioners, illustrate the significance of such individual facts. In *Gordon v. Spalding*, 268 F.2d 327 (5th Cir. 1959), the court found that "[t]he Bankrupt committed a conversion and fraud. . . ." 268 F.2d at 329. Further, the court there did not need to consider other creditors' claims to a share of the same fund. In *In re N.S. Garrott & Sons*, 772 F.2d 462 (8th Cir. 1985), the claimed fund was held in escrow by a third party, and the court found that the money had been "obtained by the debtors through a very questionable scheme," by means of a commitment for title insurance "which debtors knew to contain false information." 772 F.2d at 466. In *In re Teltronics, Ltd.*, 649 F.2d 1236 (7th Cir. 1981) and *Nicklaus v. Bank of Russellville*, 336 F.2d 144 (8th Cir. 1964), there were, underlying the constructive trust determinations, criminal fraud convictions. In *In re Liebig*, 255 F. 458 (2nd Cir. 1918) there was a finding of a "preconceived intent not to pay." 255 F. at 463-464.[3]

As the courts in some cases have, based upon the "character and ingredients" therein, found the imposition of constructive trusts to be appropriate, courts in other cases have, based upon the "character and ingredients" of such cases, found to the contrary. *See, e.g., In re Daves*, 770 F.2d 1363 (5th Cir. 1985) (state law requirements for constructive trust not met); *In re Flight Transportation Corporation Securities Litigation*, 730 F.2d 1128 (8th Cir. 1984) (constructive trust claim not so strong as to make it an abuse

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[3]Petitioners also cite the decision of the Ninth Circuit in *In re Cochise College Park, Inc.*, 703 F.2d 1339 (9th Cir. 1983), asserting that the court, in this case, has ignored the decision in that case. First, petitioners' initial citation of the *Cochise College Park* case was contained in their petition for rehearing in the court of appeals. Second, the cited portion of that case dealt with the personal liability of a trustee in bankruptcy for his own misrepresentations, and not with the standards for the imposition of a constructive trust. Third, even if there were an inconsistency between these two decisions of the Ninth Circuit, that court is capable of resolving such inconsistency. *See Davis v. United States*, 417 U.S. 333 (1974).

of discretion to approve a settlement that roughly split claimed funds in half); *In re Esgro, Inc.*, 645 F.2d 794 (9th Cir. 1981) (no fraud or other wrongful act); *In re Kennedy & Cohen, Inc.*, 612 F.2d 963 (5th Cir. 1980) (no evidence that debtor knew it could not perform contracts); *In re Paragon Securities Company*, 589 F.2d 1240 (3rd Cir. 1978) (no fraud); *Dodge Motor Trucks, Inc. v. First National Bank of Omaha*, 519 F.2d 578 (8th Cir. 1975) (no evidence of fraud or absence of good faith).

"Broken promises and unfulfilled expectations do not alone give rise to trusts." *Manget Brothers, Inc. v. Bank of Greenwood, Mississippi*, 381 F.2d 91, 99 (5th Cir. 1967). Further, not only does "the mere failure of a party to disclose that he is insolvent . . . not constitute a fraud entitling the other party to rescind the sale," *In re Paragon Securities Company*, 589 F.2d at 1244, the fact is that no court has here found either knowledge of insolvency or an intent not to perform (Pet. App. A-7).

As were the other cases, both those cited by petitioners and those cited by respondent, this case was decided by application of generally accepted rules to a case having its own "character and ingredients."

2. THERE IS PRESENTED BY THE DECISION BELOW NO CONFLICT WITH DECISIONS OF THE SUPREME COURT OF ARIZONA.

Petitioners assert that "[a] debtor's interest in property is determined by looking to state law," although "the ultimate issue of whether the property belongs to the bankruptcy estate is a federal question." (Pet. 10). There is no dispute as to these propositions.

Petitioners contend, however, that the court of appeals failed "to fully consider applicable state law" (Pet. 10), by failing "to consider and apply the Arizona law of 'constructive fraud' . . ." (Pet. 11). That is not the case. As is clear from a review of the opinion of the court of appeals (Pet. App. A-8 to A-9), that court considered "[p]laintiffs' final contention . . . that, even if the circumstances do not amount to actual fraud, we should impose a constructive trust on the ground that plaintiffs' funds were obtained

by 'means which render it unconscionable for the holder of legal title to retain and enjoy its beneficial interest.''' (Pet. App. A-9). The court declined to require the imposition of a constructive trust, pursuant to that contention, ''in the circumstances here presented.'' (Pet. App. A-9).

That the court did not use the term ''constructive fraud'' in its analysis may be explained by the fact that petitioners, while asserting that a finding of actual fraud is not necessary for the imposition of a constructive trust, did not use the term ''constructive fraud'' in their briefs on appeal.[4] Petitioners did argue that the doctrine of constructive trust is a flexible one, quoting from *Raestle v. Whitson*, 119 Ariz. 524, 582 P.2d 170 (1978), wherein the Supreme Court of Arizona in turn quoted from Justice Cardozo: '' 'A court in equity in decreeing a constructive trust is bound by no unyielding formula. The equity of the transaction must shape the measure of relief.' '' 119 Ariz. at 526, 582 P.2d at 172, quoting from *Beatty v. Guggenheim Exploration Co.*, 225 N.Y. 380, 122 N.E. 378, 380-381 (1919).

The doctrine of constructive trust is indeed a flexible one under Arizona law. A constructive trust is an equitable remedy, *King v. Uhlmann*, 103 Ariz. 136, 144, 437 P.2d 928, 936 (1968); *Condos v. Felder*, 92 Ariz. 366, 368, 377 P.2d 305, 307 (1962), ''an instrument of equity for the maintenance of justice, good faith, and good conscience.'' *Honk v. Karlsson*, 80 Ariz. 30, 34, 292 P.2d 455, 457 (1956). While the forms and varieties of constructive trusts ''are practically without limit,'' nevertheless ''the element of fraud, either actual or implied, must always be present.'' *MacRae v. MacRae*, 37 Ariz. 307, 313, 294 P. 280, 282 (1930). Further, ''[p]roof of a constructive trust must be established by clear and convincing testimony.'' *King v. Uhlmann*, 103 Ariz. 136, 142, 437 P.2d 928, 934 (1968). *Accord, Smith v. Connor*, 87 Ariz. 6, 347 P.2d 568 (1959). Whether the '' 'evidence is sufficient to be clear

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[4]The term ''constructive fraud'' was first used by petitioners in their petition for rehearing, following briefing, argument, submission, and decision by the court of appeals. The term ''constructive fraud'' is used in respondent's brief in the court of appeals.

and convincing is primarily for the trial court.' " *King v. Uhlmann*, 103 Ariz. at 142, 437 P.2d at 934.

Petitioners cannot state that, under Arizona law, they would have been entitled, as a matter of right, to this discretionary, equitable remedy, even outside the bankruptcy context. Even less can they state that they would have been entitled to this remedy in bankruptcy, where its effect would be to prefer this group of customers over others, including others who paid money to the company, for similar transactions, at exactly the same time as did the plaintiffs. As the court of appeals held, there is no "equitable principle that requires us to protect the plaintiffs' investments fully, at the expense of these other creditors. Indeed, the equities, as well as the principles underlying the bankruptcy laws, point in the other direction." (Pet. App. A-9).

3. THERE EXISTS AN ALTERNATIVE GROUND OF DECISION, WHICH DOES NOT REQUIRE CONSIDERATION OF THE QUESTIONS PRESENTED BY PETITIONERS.

Even assuming that a court had concluded that the imposition of a constructive trust was an appropriate remedy in this case, no such remedy could be granted because the plaintiffs cannot trace their funds.

Under both Arizona and federal law, the imposition of a constructive trust on a fund of money is not appropriate unless the claimants' funds can be traced. *Korrick v. Robinson*, 20 Ariz. 323, 180 P. 446 (1919). *Accord, Johnson v. American National Insurance Company*, 126 Ariz. 219, 613 P.2d 1275 (App. 1980); *Barrasso v. First National Bank*, 122 Ariz. 469, 595 P.2d 1014 (App. 1979). *Rosenberg v. Collins*, 624 F.2d 659 (5th Cir. 1980); *In re Kennedy & Cohen, Inc.*, 612 F.2d 963 (5th Cir. 1980); *Elliott v. Bumb*, 356 F.2d 749 (9th Cir. 1966); *Sonnenschein v. Reliance Insurance Co.*, 353 F.2d 935 (2nd Cir. 1965).

Although the court of appeals stated that all receipts from petitioners' transactions were deposited to the "Special Trust Account," such was not the case. Petitioners' funds were deposited, along with all other funds received, to the debtor's main depository account, with equivalent amounts later transferred. Petitioners cannot trace their funds, or distinguish their funds from those of any

other creditor, including customers who paid money to the company at the same time as did petitioners.

Although courts have adopted various rules, based upon fictitious assumptions, governing the distribution of such commingled funds,[5] the rule which best accomplishes justice under the facts of this case is that followed in *Ruddle v. Moore*, 411 F.2d 718 (D.C. Cir. 1969), that is, a rule of equal distribution among all, "pro rata according to their respective losses." 411 F.2d at 718. Such a rule would provide to the petitioners herein compensation in a proportion no greater than that provided to other creditors, and that result has, in fact, been accomplished by the decision below.

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[5]*Compare Republic Supply Co. of California v. Richfield Oil Co. of California*, 79 F.2d 375 (9th Cir. 1935) ("lowest intermediate balance" test) *with Empire State Surety Co. v. Carroll County*, 194 F. 593 (8th Cir. 1912) ("first in, first out").

CONCLUSION

For the reasons set forth above, the petition for a writ of certiorari should be denied.

Respectfully submitted,

JEFFREY STUART LEONARD
1840 First Interstate Bank Plaza
100 West Washington Street
Phoenix, Arizona 85003
Telephone: (602) 254-5071

Counsel for Respondent

Daughton Feinstein & Wilson
Joanne T. Stark
Of Counsel

February, 1986

APPENDIX

EXCERPTS FROM THE DEPOSITION OF DAVID B. WEEKLY

(January 27 and February 15, 1983)

"Q. Had the segregated account for customers' funds ever been used at North American Coin prior to September 13th, '82?

A. No. There was a trust account, but it wasn't really a segregated funds account, it was just labeled as such.

Q. What kind of money was put into that trust account?

A. All customer's [sic] funds coming in and out, disbursements and receipts were done from that account and posed [sic] to the general fund account." Page 108.

* * *

"A. That account has been used as the deposit account for all customers' receipts, retail and wholesale, for at least the last, the two years proceeding [sic] the bankruptcy that I am aware of.

Q. Does any other type of money go into that account?

A. All cash receipts go into that account." Page 126.

* * *

"Q. I take it you have it within your ability to trace those [class members'] transactions into that segregated account?

A. That was the purpose of the reports that were generated. You cannot trace, you cannot trace customer A's check into that account. You can trace customer A's check from the receipt to the deposit in the account that it was deposited into and then you can trace the transfer of funds from the account it was deposited into

into the segregated account." Page 51.

* * *

"THE WITNESS: If I recall the question correctly, whose funds were put in the account?

BY MR. LEHMAN:

Q. Yes.

A. The way I will answer this is how the funds were put into the account. To the best of my knowledge, no funds were deposited in that account on the 13th. What happened is a report was generated the evening of the 13th, which asked the computer to list those transactions which were entered into that day, for which receipts had been received. The receipts themselves were deposited into whichever bank was normally used to deposit those funds in, I don't recall, and the amount of the receipts that fell within the description I just gave you the next morning were transferred into this special segregated bank account." Pages 46-47.